[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX PROVISIONS OF S. 544

(THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT)

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON APRIL 13, 1983

Prepared for the Use of the

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BY THE STAFF OF THE

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on April 13, 1983, on S. 544, the Caribbean Basin Economic Recovery Act (introduced by Senators Dole, Baker, Percy, Danforth, Heinz, Symms, and Wallop). This bill embodies the tax and trade portions of the Administration's Caribbean Basin Initiative, and would provide economic benefits to certain Caribbean Basin countries through trade assistance (including discretionary tariff reductions) and through tax incentives for business conventions. The bill would also transfer to Puerto Rico and the U.S. Virgin Islands the excise tax revenues from all rum imported into the United States. The House passed a similar bill late in the 97th Congress.

This pamphlet, prepared in connection with the hearing on S. 544, contains a description of the tax provisions of the bill (Title II). This pamphlet does not describe the bill's trade assistance provisions (in Title I).

The first part of this pamphlet is a summary of the bill's tax provisions. The second part is a more detailed description of those provisions, including present law, effective dates, prior congressional consideration, and issues. The third part presents estimates of the revenue effects of those provisions.

I. SUMMARY OF THE BILL'S TAX PROVISIONS

Rum excise taxes

Under present law, the United States imposes an excise tax of $10.50 per proof gallon on all distilled spirits, including rum, manufactured in or imported into the United States. The excise taxes paid on rum made in Puerto Rico or the U.S. Virgin Islands and brought into the United States are transferred to the Treasury of the possession where the rum was made. The bill would require that all excise taxes collected on other rum brought into the United States (whether or not from Caribbean countries) be transferred to the Treasuries of Puerto Rico and the Virgin Islands, under a formula to be prescribed by the Secretary of the Treasury. This provision would apply to rum imported into the United States after June 30, 1983.

Convention expense deductions and exchange of tax information

The Internal Revenue Code generally disallows deductions for business expenses incurred while attending a convention held outside the North American area (the United States, the U.S. possessions, the Trust Territory of the Pacific Islands, Canada, and Mexico), unless the taxpayer can show that it is as reasonable to hold the convention outside the North American area as within it. In addition, the income tax treaty with Jamaica treats specified business deductions incurred while attending a convention held in Jamaica as though the convention were held in the United States. The bill would allow business expense deductions for attending conventions held in a Caribbean country that is a "beneficiary country," as defined in section 102 of the bill (with the addition of Bermuda), that has in effect an agreement with the United States to exchange tax information, and that does not discriminate against U.S. convention sites in its tax law. The provision would apply to conventions beginning after June 30, 1983, in countries with which such agreements are in effect.

II. DESCRIPTION OF THE TAX PROVISIONS OF S. 544

(The Caribbean Basin Economic Recovery Act)

A. Present Law

Rum excise taxes

An excise tax of $10.50 per proof gallon is imposed on distilled spirits (including rum) produced in or imported into the United States (Code sec. 5001). The tax is imposed on the manufacturer or on the importer of the distilled spirits and is payable at the time the spirits are removed for consumption or sale from the distillery, or from customs custody in the case of imported spirits. Generally, merchandise manufactured in Puerto Rico and brought into the United States for consumption or sale or merchandise coming into the United States from the U.S. Virgin Islands is subject to a tax equal to the tax imposed in the United States upon similar merchandise of domestic manufacture (sec. 7652).

All taxes collected under the Internal Revenue Code on articles produced in Puerto Rico and transported to the United States (less the estimated amount necessary for payment of refunds and drawbacks), or consumed on the island, are deposited into the Treasury of Puerto Rico. Internal revenue collections (less certain amounts deposited to the U.S. Treasury as miscellaneous receipts) on articles produced in the Virgin Islands and transported to the United States are paid to the Treasury of the Virgin Islands.

The Virgin Islands Government may spend the money received under this provision during a fiscal year only for emergency relief and essential public projects. It may carry no more than $5 million of such receipts forward from one year to the next; the excess is returned to the U.S. Treasury.

Business expense deduction for conventions in certain countries

A deduction is allowed for the ordinary and necessary expenses of carrying on a trade or business or income-producing activity, including transportation expenses and amounts expended for meals and lodging while away from home in pursuit of a trade or business or income-producing activity (Code sec. 162). Only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. Fees charged for admission to a convention or other meeting generally are deductible if there is a sufficient relationship between the taxpayer's trade or business or income-seeking activity and attendance at the convention or other meeting. Therefore, generally, a deduction is allowed for the costs of attending a convention or seminar in pursuit of a trade or business or income-producing activity.

A special rule (Code sec. 274(h)) applies to expenses for attendance at conventions, seminars, or similar meetings if held outside

the United States, its possessions, Canada, Mexico, or the Trust Territory of the Pacific Islands (the "North American area"). (Conventions, etc., held outside the North American area commonly are referred to as "foreign conventions.") No deduction is allowed for the expenses of attending a foreign convention unless the taxpayer establishes that the cost is directly related to the active conduct of a trade or business or income-producing activity and that it is as reasonable to hold the meeting outside the North American area as within it (sec. 274(h)(1)).[1] This rule applies both to the expenses paid by individuals attending such conventions and to expenses paid by employers of such individuals.

A deduction is allowed for up to $2,000 of the expenses of attending a business convention or similar meeting held on a U.S. flag cruise ship if the ship calls on ports only in the United States and the U.S. possessions (sec. 274(h)(2)).

Exchange of tax information

Under current law, the United States has difficulty in obtaining information to enforce its tax laws when transactions occur (or when information is located) overseas. The United States has entered into income tax treaties that provide for exchanges of information to enable the United States and its treaty partner to enforce the tax laws which are covered by the treaty. However, the operation of exchange of information articles in some treaties is not satisfactory, because the other country may not disclose certain kinds of information, such as information regarding the ownership of bank accounts or the beneficial ownership of trusts or corporations. Moreover, the United States has treaties with few Caribbean countries, in part because some of those countries do not generally impose income taxes.

B. Explanation of Tax Provisions

1. Rum excise taxes

All distilled spirits excise taxes collected (under section 5001(a)(1) of the Internal Revenue Code) on rum imported into the United States from outside the country,[2] whether or not from a Caribbean Basin country, would be paid over to the treasuries of Puerto Rico and the Virgin Islands.[3]

These payments would be reduced by the estimated amount necessary for payment of refunds and drawbacks. The bill would not impose restrictions on the uses to which the Government of the Virgin Islands or the Government of Puerto Rico put the revenues they received under this provision.

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[1] Under the United States-Jamaican income tax treaty, deductions are permitted for certain expenses of attending a convention in Jamaica (Art. 25(7)). This treaty does not provide for reciprocal treatment by Jamaica of U.S. conventions. As part of the agreement granting favorable convention treatment to Jamaica, Jamaica made substantial concessions on the issues of treaty use by third-country persons and exchanges of tax information.

[2] No possession other than the Virgin Islands and Puerto Rico now produces rum for sale in the United States. The bill would treat rum produced by other possessions like rum produced by foreign countries.

[3] Jamaica accounted for over 64 percent of all rum imported for consumption in the United States in 1982 from foreign countries; Barbados for over 11 percent. No other country accounted for as much as 6 percent of imports. U.S. Department of Commerce, *U.S. General Imports and Imports for Consumption December 1982*, 2-26 (issued March 1983).

The Secretary of the Treasury would prescribe by regulation a formula for the division of tax collections between Puerto Rico and the Virgin Islands. The Secretary could change this formula from time to time.

Rum would be defined by reference to the Tariff Schedules of the United States, 19 U.S.C. 1201, so as to include *cana paraguaya.*

Effective date.—This provision would apply to rum imported into the United States after June 30, 1983.

2. Convention deductions and exchange of tax information

The bill would allow deductions for the ordinary and necessary expenses (in pursuit of a trade or business or income-producing activity) of attending conventions and similar meetings in those countries among the Caribbean Basin countries and Bermuda that meet three criteria discussed below. The taxpayer would not have to establish that holding a convention in a country meeting these criteria was as reasonable as holding it in another location.

First, the only countries that could qualify for this convention treatment would be beneficiary countries, as defined in section 102(a)(1)(A) of Title I of the bill, and Bermuda. Beneficiary countries are those among certain enumerated countries and territories,[4] including Guyana, Surinam, and countries located in the Caribbean and Central America, that the President designates as beneficiaries of the bill.

In determining whether to designate any country a beneficiary country under this Act, the President is to take into account a variety of factors, including an expression by the country of its desire to be so designated, the economic conditions in the country, the living standards of its inhabitants and other economic factors that he deems appropriate, and the degree to which the country follows certain accepted rules of international trade. No one of these factors alone, however, is sufficient to require or to prevent designation. Before the President designates any country as a beneficiary country for purposes of the bill, he must notify the House of Representatives and the Senate of his intention to make the designation, together with the considerations entering into his decision.

Notwithstanding these factors, the bill provides six kinds of countries that the President generally cannot designate as beneficiary countries: Communist countries, countries that seize property of U.S. persons, countries that refuse to honor certain international arbitral awards, countries that favor products of other developed countries over U.S. products, countries that violate U.S. copyrights, and countries that are not parties to a treaty regarding the extradition of U.S. citizens.

The President may terminate designation of a country as a beneficiary country, but only if at least sixty days before such termination, he has notified the House of Representatives and the Senate

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[4] The countries and territories are: Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Belize, Costa Rica, Cuba, Dominica, the Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Nicaragua, Panama, Saint Lucia, Saint Vincent and the Grenadines, Surinam, Trinidad and Tobago, the Cayman Islands, Montserrat, the Netherlands Antilles, Saint Christopher-Nevis, Turks and Caicos Islands, and the British Virgin Islands. The bill defines country to include overseas dependent territories and possessions. Successor political entities of the enumerated countries and territories would be eligible for the benefits of the bill.

and has notified such country of his intention to terminate such designation, together with the considerations entering into such decision. The President must terminate an existing designation (after complying with the notification requirements above) if he determines that, because of changed circumstances, a country is no longer eligible for beneficiary country status.

Second, deductions would be available only for expenses of attending conventions held in countries with which an agreement with the United States to exchange tax information was in force at the time the convention began. The bill would authorize the Secretary of the Treasury to negotiate and conclude such agreements, which may be bilateral or multilateral. Such an agreement would provide, on a reciprocal basis, for information relating to U.S. tax matters to be made available to persons or authorities (including courts and administrative bodies) involved in the administration of U.S. taxes (including assessment and collection of taxes and enforcement and prosecution in respect of taxes) or oversight of the administration of such taxes (a role of the Senate Committee on Finance, the House Committee on Ways and Means, the Joint Committee on Taxation, and the General Accounting Office), or in the determination of appeals in respect of such taxes.

The exchange of information agreement would have to apply to and include provisions relating to both civil and criminal tax matters within the U.S. meaning of those concepts. While the bill would accord the Secretary discretion regarding what kinds of information would be included within the scope of the exchange of information provisions, it would provide certain standards for such agreements. The agreement would have to apply to information relevant to tax matters of the United States or of the beneficiary country whether or not that information concerned nationals or residents of the United States or the beneficiary country.

The bill would mandate that the agreement require production of information notwithstanding local rules requiring secrecy about such information as the ownership of bank accounts, trusts or bearer shares. In this respect, the agreements contemplated by the bill may go beyond the exchange of information articles of some U.S. tax treaties, which may defer to local secrecy laws. The agreement would impose on the officials of each country a duty not to disclose this information to persons other than those involved in its tax administration. The provision would make it clear that exchange of information agreements would be treated as income tax conventions for the purpose of the Code rule that allows U.S. tax officials to disclose tax information to foreign tax officials pursuant to such conventions (sec. 6103(k)(4)).

The information to be exchanged under the agreement would not be limited to information about any particular class of transactions. The bill would require the exchange of such information as may be necessary or appropriate to carry out U.S. or foreign tax laws.

The exchange of information agreements would generally become effective on signature. The text of the agreements would have to be transmitted to Congress no later than sixty days after the agreement had been signed, in accordance with the Case Act (1 U.S.C. section 112b).

Any exchange of information agreements would be terminable by either country on reasonable notice. No deductions would be allowed for business expenses of conventions or similar meetings begun in a country after termination of the exchange of information agreement. Termination should occur if, for example, the other country were not abiding by its obligations under the agreement to supply information or to maintain confidentiality. Termination would occur in the manner set forth in the agreement.

Third, deductions would not be available for conventions in any country that began after publication in the Federal Register of a finding by the Secretary that that country discriminated in its tax laws against conventions and similar meetings held in the United States or the U.S. possessions. The Secretary could withdraw such a finding by a subsequent announcement in the Federal Register.

Effective date.—This provision would apply to conventions beginning after June 30, 1983, but only if an exchange of information agreement were in effect on the day the convention began.

C. Prior Congressional Consideration

S. 544 generally embodies tax provisions that (together with nontax portions of the Caribbean Basin Initiative) passed the House of Representatives on December 17, 1982, as H.R. 7397.[5] The Senate Committee on Finance ordered that bill reported on December 20, 1982,[6] with modifications to certain nontax provisions of the bill but without modifications to the tax provisions, by a vote of 11 to 5. The Senate did not consider the reported bill before adjournment sine die of the 97th Congress.

S. 544 differs from the tax portion of H.R. 7397 only as to effective dates: under H.R. 7397, excise taxes collected on all rum imported into the United States on or after January 1, 1983 would have been transferred to Puerto Rico and the Virgin Islands. The corresponding date in S. 544 is June 30, 1983. Under H.R. 7397, convention deductions would have been available for conventions beginning after December 31, 1982. The corresponding date in S. 544 is June 30, 1983.

D. Issues

The tax provisions of the bill (Title II) present the following issues:

(1) Should revenues attributable to excise taxes on rum from all countries be paid to Puerto Rico and the Virgin Islands?

(2) If excise tax revenues on all imported rum are paid to Puerto Rico and the Virgin Islands, should Congress prescribe the formula for division of revenues between Puerto Rico and the Virgin Islands or delegate division of revenues to the Secretary of the Treasury?

(3) Should Congress allow deductions for conventions in certain countries that have agreed to exchange tax information with United States?

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[5] See also report of the Committee on Ways and Means (H. Rep. No. 97-958, December 10, 1982; House Calendar 602).

[6] The bill was reported on December 21, 1982; however, no written report was filed by the Committee on Finance (see Senate Calendar 1031).

III. REVENUE EFFECT

It is estimated that the provision transferring rum exise tax revenues to Puerto Rico and the Virgin Islands would reduce fiscal year receipts by $2 million in 1983, and by about $10 million annually during the period 1984–88. This estimate does not take into account behavorial change that may result because of enactment of the proposal. Consequently, it should be regarded as a minimum estimate.

It is estimated that the provision allowing deductions for certain business conventions and similar meetings in Caribbean countries and Bermuda would reduce fiscal year receipts by less than $5 million per year.

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